SUPREME COURT OF THE UNITED STATES

MAR 6 1974

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1973.

No. 73-1201.

CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY, GRAND TRUNK WESTERN RAILROAD COMPANY and ST. LOUIS-SAN FRANCISCO RAILWAY COMPANY,

Petitioners,

v.

GEORGE P. BAKER, RICHARD C. BOND, and JERVIS LANGDON, JR., TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION

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INDEX

	Page
Opinions Below	1
Question Presented	2
Statutes Involved	2
Statement of the Case	3
Reasons for Denying the Writ	7
Conclusion	11
Appendix—Statutory Provisions Involved	B1

TABLE OF CASES CITED

	Page
Ahnapee & W. Ry. Co. v. Akron & B.B.R. Co., 302 I.C.C. 265 (1957)	8
Baltimore & O.R. Co. v. New York, N.H. & H.R. Co., 196 F. Supp. 724 (S.D.N.Y. 1961)	8
Boston & Maine Corp. v. Chicago, Burlington & Quincy R., 258 F. Supp. 930 (S.D.N.Y. 1966), aff'd. 381 F.2d 365 (2d Cir. 1967)	6
Chicago, R.I. & P. Ry. Co. v. U.S., 284 U.S. 80 (1931)	8
In re New York, New Haven and Hartford Railroad Co., 278 F. Supp. 592 (D. Conn. 1967), aff'd. 405 F.2d 50 (2d Cir. 1968)	11
In re Penn Central Transportation Co., 453 F.2d 520 (3d Cir. 1971), cert. den. 408 U.S. 923 (1972)	9
In re Penn Central Transportation Co., 477 F.2d 841 (3d Cir. 1973), aff'd. sub nom. U.S. Steel Corp. v. Trustees of Penn Central Trans. Co., — U.S. — (42 L.W. 3213), and cert. den. sub nom. In re Penn Central Trans. Co., — U.S. — (42 L.W. 3213)	9
Rules for Car Hire Settlement, 160 I.C.C. 369, 165 I.C.C. 495 (1930)	7, 8

MISCELLANEOUS

	Page
Bankruptcy Act (11 U.S.C. 205(b)):	
Section 77	2, 3, 10
Section 77(b), (c)(4) and (c)(7)	2, 11
Interstate Commerce Act (49 U.S.C. § 5b(2)):	
Section 5a(2) and (6)	2, 8

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OPINIONS BELOW

The opinion of the United States District Court for the Eastern District of Pennsylvania is reported at 340 F. Supp. 857 (E.D. Pa. 1972) and is printed in the Appendix

(A1) to the Petition. The opinion of the Court of Appeals for the Third Circuit, filed October 9, 1973, as amended by its order filed November 6, 1973, is reported at 486 F.2d 519 (3d Cir. 1973). The opinion and amending order are printed in the Appendix (A16, A43) to the Petition.

QUESTION PRESENTED

Whether the United States Court of Appeals for the Third Circuit was correct in affirming the decision of the United States District Court for the Eastern District of Pennsylvania that the per diem net balances owing to petitioners at the time that the Debtor railroad went into reorganization under Section 77 of the Bankruptcy Act did not constitute a trust and were not entitled to payment or setoff against amounts owing to respondents on other interline accounts, and that whether such balances are entitled to an equitable lien and priority over other creditors should await classification of claims in the proof of claims program.

STATUTES INVOLVED

Section 77(b), (c)(4) and (c)(7) of the Bankruptcy Act (11 U.S.C. 205(b), (c)(4) and (c)(7)), Section 5a(2) and (6) of the Interstate Commerce Act (49 U.S.C. § 5b(2) and (6)) are set forth in pertinent part in the Appendix hereto (B1 to B3).

STATEMENT OF THE CASE

The respondents are the Trustees of the property of Penn Central Transportation Company (Penn Central), Debtor in reorganization under Section 77 of the Bankruptcy Act in the United States District Court for the Eastern District of Pennsylvania, No. 70-347. Among the unpaid debts of Penn Central when it filed its petition for reorganization on June 21, 1970, were amounts owing on account of per diem for rental of freight cars of other railroads which came due on June 10, 1970, for use of the cars of such railroads, including petitioners, in April, 1970, and prior months.

In addition to these per diem accounts, Penn Central also owed other railroads for other interline accounts such as freight and passenger charges, switching, car repairs, loss and damage and freight overcharges. In turn, such other railroads owed Penn Central balances on interline accounts.

Under Order No. 1 in its reorganization proceeding, Penn Central was authorized, in its discretion, to pay all current expenses incurred in operating, maintaining and preserving its railroad, including all interline accounts and balances owing by the Debtor. Not content with this authorization regarding payment of post-bankruptcy accounts, Burlington Northern, Inc., a railroad creditor, sought and obtained Order No. 9, an amendment to Order No. 1 (Jt. App. 32a) [1] directing the Debtor to pay such balances as they became due. Order No. 9 was without prejudice to creditor railroads to claim a priority with respect to pre-bankruptcy interline accounts and balances.

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1. The reference "Jt. App. —a" is to the Joint Appendix filed in the Court of Appeals. The reference "A—" is to the Appendix to the Petition. The reference "Pet. —" is to the Petition itself.

Other railroads, including petitioners, then proceeded to offset what Penn Central owed them on account of pre-bankruptcy interline accounts against what they owed Penn Central for such accounts. Because of such action, the Penn Central Trustees were deprived of revenue approximating $4.3 million and they petitioned their Reorganization Court to enjoin such setoffs, which were contrary to Order No. 1 in the Penn Central reorganization proceeding (Jt. App. 34a).[2] The railroads against which such action was brought, including petitioners, claimed that the pre-bankruptcy interline balances owed to them by Penn Central constituted a trust, that they were entitled to payment, or in the alternative, that equitable liens should be impressed on account of such balances, and that they were entitled to set them off against amounts that they owed Penn Central, pre-bankruptcy, on account of interline balances. The Reorganization Court rejected these contentions and enjoined the setoffs, without prejudice to assertion of claims for priority of interline accounts over other creditors at a later date in the proof of claims program (A10-12).

On appeal to the United States Court of Appeals for the Third Circuit, that Court held that the interline freight and passenger balances owed to other railroads by the Debtor constituted a trust and ordered payment of such balances. This holding is the subject of a petition to this Court by the Trustees of Penn Central for a writ of certiorari, October Term, 1973, No. 73-914. In other respects,

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2. In Order No. 1, entered June 21, 1970, it was provided (paragraph 10):

> "All persons, firms and corporations . . . holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined from selling, converting or otherwise disposing of such collateral, deposit balances or other credits, or any part thereof, or from off-setting the same, or any thereof, against any obligation of the Debtor, until further order of this Court."

the Court of Appeals affirmed the decision of the Reorganization Court, holding that there was no trust relationship for interline accounts other than freight and passenger, and, that in the absence of a trust relationship on other accounts, whether to permit a setoff is in the discretion of the district court, which had not abused its discretion. Through the Court of Appeals' affirmance of the Reorganization Court with respect to other interline accounts, the status of such other interline accounts, including per diem, was deferred to the classification of claims under the proof of claims program.

Although the Code of Car Hire Rules and Disbursements Mandatory Rules provide that net balances for per diem are subject to draft immediately upon the report of per diem balances, which is no later than the tenth day of the second month following that in which the per diem accrued (Jt. App. 76a-77a), petitioners' drafts for net per diem balances owing by the Debtor on the June, 1970, reporting date were not presented for payment until after the inception of the Debtor's reorganization proceeding on June 21, 1970 (Pet. p. 8).

Under the Accounting Rules of the Association of American Railroads, which apply to interline accounts, each account is settled on its own, either on a gross or net basis, and interline balances covering different accounts, *e.g.*, freight and per diem, could not be netted (Jt. App. 78a-79a). Petitioners were attempting to accomplish such netting of different accounts by setting off other accounts owed to Penn Central against the per diem owed to them by Penn Central.

Under procedures pursuant to the Mandatory Arbitration Rules of the Association of American Railroads it was held in Interline Freight Arbitration Case No. 20141, *Boston and Maine Corporation v. Chicago and North-*

western Railway Company, that C&NW violated Freight Mandatory Rule 149 when it refused to honor B&M's drafts for settlement of interline freight balances because of an unrelated dispute between the two roads concerning car service balances (Jt. App. 79a). A similar arbitration award was upheld in *Boston & Maine Corp. v. Chicago, Burlington & Quincy R.*, 258 F. Supp. 930 (S.D.N.Y. 1966), *aff'd.* 381 F.2d 365 (2d Cir. 1967).

REASONS FOR DENYING THE WRIT

The petition should be denied because it attempts to obtain a decision from this Court on matters which both the Reorganization Court and the Circuit Court of Appeals have left open for future consideration in the program for classification of claims in the Debtor's reorganization proceeding. In this respect, the instant petition differs entirely from that of the Penn Central Trustees filed at Docket No. 73-914. Denial of the Penn Central Trustees' petition would completely foreclose any further relief with respect to the question of the status of freight and passenger interline balances. Here, the question of the status of per diem claims is left open for determination at a later stage in the proceedings.

Petitioners argue at length that their claims for prebankruptcy net interline per diem balances are those of involuntary creditors superior to the claims of voluntary creditors, but it does not follow that the Court of Appeals, in affirming the decision of the Reorganization Court, was in error in holding that petitioners were not entitled to payment or setoff, or to a declaration of an equitable lien for such claims at this time.

Petitioners' arguments with respect to the nature of their interline claims were fully considered by both Courts and it is of no consequence to their decisions that petitioners did not then refer to *Rules for Car Hire Settlement*, 160 I.C.C. 369, 165 I.C.C. 495 (1930), regarding their claim of involuntary creditor status. The only significance of the lower Courts' not noting this decision is the tacit concession by petitioners (Pet. p. 11) that their present argument with respect to this decision was not presented to either Court, and is now cited for the first time in this Court. Nor, in the light of the thrust of the decision of

the Court of Appeals, can it be said that it is in conflict with this Court's decision in *Chicago, R.I. & P. Ry. Co. v. U.S.*, 284 U.S. 80 (1931), in which the Court upheld the car hire settlement rules approved by the Commission.

In making its statement that "there is no compulsion, statutory or otherwise as to the manner by which the services shall be paid," to which petitioners take exception, the Court of Appeals was considering whether set-offs should be allowed or payments required with respect to the car repair, overcharge, loss and damage, per diem, and switching accounts. Nor is it certain that as to the periods covered by these claims there was any compulsion even with respect to per diem. The 1930 Commission decision relied on by petitioners antedated by 18 years the enactment by Congress of Section 5(a) of the Interstate Commerce Act which requires that, with respect to any agreement among carriers relating, *inter alia*, to the compensation paid for the use of equipment, the right of independent action of any carrier be preserved free and unrestrained. Interstate Commerce Act, §§5a(2), 5a(6), 49 U.S.C. §§5b(2), 5b(6). Until the Interstate Commerce Commission prescription of rates became effective in September, 1970 (after the period here in question), certain railroads did exercise that right, despite the alleged compulsion of the Rules for Car Hire Settlement. See *Ahnapee & W. Ry. Co. v. Akron & B.B.R. Co.*, 302 I.C.C. 265 (1957); *Baltimore & O.R. Co. v. New York, N.H. & H.R. Co.*, 196 F. Supp. 724, 731-735 (S.D.N.Y. 1961).

In any event, the Court's holding that the amounts owing on these accounts could not be set off was based on the conclusion that they were not held in trust which was premised on the recognition that no money is collected as to these accounts by Penn Central for other railroads and

did not depend on whether arrangements for payment or credit were voluntary (A32-33).

After its holding that a trust did not exist for these debtor-creditor accounts, the Court of Appeals reaffirmed the Reorganization Court's authority to preclude setoffs.

> ". . . The threat to the reorganization that we noted in the *Bank Cases* is present in the assertion of these setoffs. Penn Central's choses in action for the various interline charges are entitled to the same status as the freight charges in the *Shipper Cases* and the deposits in the *Bank* Cases. The district court concluded that to permit setoffs could discriminate against many other suppliers of services and equipment and would be unfair because of the unresolved issue of the relative priorities of claims. It also concluded that Penn Central's cash position would be unduly injured by allowing setoffs.
>
> "In the absence of a trust relationship, whether to permit a setoff is in the discretion of the district court. See *Susquehanna Chemical Corp. v. Producers Bank & Trust Co.*, 174 F.2d 783, 786-87 (3d Cir. 1949). We find no abuse of discretion in the circumstances of this case." (A35)[3]

As already noted, petitioners have not been precluded from asserting their claims for per diem balances in the Debtor's reorganization proceeding. As stated by the Reorganization Court in prohibiting setoffs (A10):

3. The "Bank Cases" referred to in the quoted material are *In re Penn Central Transportation Co.*, 453 F.2d 520 (3d Cir. 1971), *cert. den.* 408 U.S. 923 (1972). The "Shipper Cases" are *In re Penn Central Transportation Co.*, 477 F.2d 841 (3d Cir. 1973), *aff'd.* sub nom. *U.S. Steel Corp. v. Trustees of Penn Central Trans. Co.*, — U.S. — (42 L.W. 3213), and *cert. den.* sub nom. *In re Penn Central Trans. Co.*, — U.S. — (42 L.W. 3213).

"... The claims of the interline railroads arose out of transactions which were a vital part of the Debtor's day-to-day business. Such claims would probably fall within the so-called 'six-months' rule' which has been held applicable in § 77 proceedings, and would likely be entitled to a high priority. *E.g.*, 5 *Collier on Bankruptcy*, par. 77.21 nn. 27-29 (1970).

"But, just as in the 'shippers' case,' several factors persuade me that set-offs should be prohibited at this time. First, to permit set-offs could discriminate against the many other suppliers of services and equipment to the Debtor. At the hearing on July 1, it was estimated that pre-petition claims by these suppliers would aggregate over $200 million. In view of the substantial uncertainty that the interline railroads will be able to establish a distinction between their claims and the claims of the Debtor's trade creditors, it would not be appropriate to permit the interline railroads to resolve the question favorably to themselves through the self-help remedy of set-off prior to determination of the question in the proof of claims program."

Likewise, with respect to the interline railroads' claim for an equitable lien, the Reorganization Court held that a decision should await the classification of the interline railroads' claims in the proof of claims program, noting that other creditors had not had the opportunity to express themselves (A11).

In these circumstances, the petition does not present a matter which warrants a determination by this Court. The procedures for the establishment and status of petitioners' per diem claims in the Debtor's reorganization proceeding are provided in Section 77 of the Bankruptcy Act and the decisions of the courts below are without prejudice to their

resort to such procedures. In other railroad reorganization proceedings, the status of pre-bankruptcy interline per diem claims has been determined in classification of claims in a proof of claims program under Section 77(b), (c)(4) and (c)(7), and such determination should be made with respect to petitioners' per diem claims. See *In re New York, New Haven and Hartford Railroad Co.*, 278 F. Supp. 592 (D. Conn. 1967), *aff'd.* 405 F.2d 50 (2d Cir. 1968).

CONCLUSION

This petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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Appendix.

STATUTORY PROVISIONS INVOLVED.

Interstate Commerce Act.

49 U.S.C. § 5b(2).

(2) Any carrier party to an agreement between or among two or more carriers relating to rates, fares, classifications, divisions, allowances, or charges (including charges between carriers and compensation paid or received for the use of facilities and equipment), or rules and regulations pertaining thereto, or procedures for the joint consideration, initiation or establishment thereof, may, under such rules and regulations as the Commission may prescribe, apply to the Commission for approval of the agreement, and the Commission shall by order approve any such agreement (if approval thereof is not prohibited by paragraph (4), (5), or (6) of this section) if it finds that, by reason of furtherance of the national transportation policy declared in this Act, the relief provided in paragraph (9) of this section should apply with respect to the making and carrying out of such agreement; otherwise the application shall be denied. The approval of the Commission shall be granted only upon such terms and conditions as the Commission may prescribe as necessary to enable it to grant its approval in accordance with the standard above set forth in this paragraph.

49 U.S.C. § 5b(6).

(6) The Commission shall not approve under this section any agreement which establishes a procedure for

the determination of any matter through joint consideration unless it finds that under the agreement there is accorded to each party the free and unrestrained right to take independent action either before or after any determination arrived at through such procedure.

Bankruptcy Act.

11 U.S.C. § 205(b).

(b) . . . The term "claims" includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors . . .

11 U.S.C. § 205(c)(4).

(c)(4) The judge shall require the officers of the debtor or the trustee or trustees, at such time or times as the judge may direct, and in lieu of the schedules required by section 7 of this Act, to file with the court such schedules and submit such other information as may be necessary to disclose the conduct of the debtor's affairs and the fairness of any proposed plan; and shall direct the officers of the debtor, or the trustee or trustees, within such time as the judge shall set, to prepare and file with the court a list of all known bondholders and creditors of the debtor, and the amounts and character of their debts, claims, and securities, and the last known post-office address or place of business of each bondholder and creditor, and a list of all known

stockholders of the debtor, with the last known post-office address or place of business of each, which lists the judge may require to be brought down to date at any time. The contents of such lists shall not constitute admissions by the debtor or the trustees in a proceeding under this section or otherwise.

11 U.S.C. § 205(c)(7).

(c)(7) The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests. The trustee or trustees under any mortgage, deed of trust, or indenture outstanding against the property may, within the time prescribed, file a verified claim in behalf of all bonds or securities outstanding under such mortgage, deed of trust, or indenture, in which event it shall be unnecessary for the holders of such bonds or securities to file claims in their own behalf, but nothing herein shall constitute such trustee or trustees the representative or representatives of such holders for the purpose of accepting or rejecting any plan of reorganization.